

ICPS newsletter[®]

How to develop an economy at the local level: Tips from the World Bank and LGI

When the children of North African immigrants rioted in France last autumn and when poor ethnic Albanians pushed Macedonia to the brink of civil war in 2001, the cause of the unrest was similar. In both cases, a marginalized population was protesting uneven development. Central European and former soviet countries need to provide incentives for local economic development (LED). The latest issue of "Gosudarstvennoye upravleniye v perekhodnykh ekonomikakh"—the Russian-language version of the Local Governance Brief—looks at ways to ensure that LED efforts in Central European and FSU countries are effective and inclusive

Uneven economic development poses a threat

Different levels of economic development can be observed in various locations in Central Europe and the former Soviet Union. Some cities are attracting hi-tech industry, blossoming as tourism centers or adding roads and other infrastructure. Others are not utilize their potential, live on subsidies from the capital and their infrastructure is in decay. The "lucky" towns enjoy better employment and a higher tax base, while the "unlucky" ones that do not manage to ensure a competitive business environment have high unemployment and the typical social problems that accompany poverty.

In fact, the successful development of some cities and the failure of the others pose a threat to the state. If regional development is uneven and the society does not grow as a unified whole, social tensions are likely to arise.

LGI and the World Bank support LED planning

The countries of Central Europe and the former Soviet Union are in desperate need of strategically planned local economic development (LED), to provide incentives for local businesses and create jobs.

The Local Government and Public Service Reform Initiative (LGI) and the World Bank are two international organizations that have been supporting LED planning in the region, and they have learned valuable lessons through this work. The overarching aim of the approach that LGI and the World Bank use in their LED programs is to get

local governments to take the lead in this work.

LED is essentially about maximizing the potential of a range of factors, including location, physical infrastructure, human resources, capital, knowledge, technology, industrial structure, quality of life, investment climate, and institutional capacity.

A well-wrought strategy is the key to success

Establishing a healthy economic environment that supports a variety of businesses first of all requires planning. An LED strategy that covers a broad base of local participants involved in this process can help a local government body to form a realistic plan that meets everybody's needs.

A well-developed strategy is also needed to obtain loans or foreign assistance. Designing and implementing an LED strategy can help communities enhance their prospects for economic growth.

The 5 stages of LED planning

1. Organizing the effort: To successfully organize an LED strategy, institutional arrangements and stakeholder involvement must be established at an early stage in the planning. An LED team should be established within the municipality.

2. Local economy assessment: LED strategic planning is based on an assessment of the economic features of a local area and its position in the regional, national, and even global economy. This local economy assessment helps to identify driving economic forces.

3. Strategy-making: In devising a strategy, practitioners in municipal governments and principal stakeholder groups are encouraged to balance economic needs with environmental and social needs.

4. Strategy implementation: To begin encouraging development, the appropriate actors must carry out the ideas set forth in the plan.

5. Strategy review: To determine what changes are needed to improve the strategy, the progress, success and failures of a strategy must be evaluated on a regular basis.

Once the community has completed a local economy assessment and identified an LED vision, goals and objectives, community members must decide on the key programs that will become the core of their LED strategy.

Involving stakeholders is the guarantee of a positive result

Successful planning encompasses a thorough assessment of a municipality's current situation, discussion of alternative options, and an assessment of projected outcomes. It is thus vital that a broad spectrum of local stakeholders be intimately involved in the planning stages. Not only does this ensure that local realities are understood and considered, but it also guarantees a maximum degree of local ownership of the plan that is ultimately developed. Usually, stakeholder groups consist of: 1) the municipal government; 2) the private sector; 3) community groups; 4) NGOs and other community sector institutions.

LED strategic planning: Breaking eggs to get an omelette

Strategic planning can be a lengthy and arduous exercise. Accomplishing this task is a challenge for any community. For a region's economically marginalized municipalities, which often do not have a tradition of public participation and public-private cooperation, the challenge is greater still.

Despite the challenges, it is apparent that the benefits of strategic planning far outweigh the difficulties involved. LED strategic planning offers a city considerable direct and indirect rewards.

Another crucial benefit of the planning process is that it creates and formalizes partnerships. One particularly important aspect of this work is building bridges between the public and private sectors.

A well-formulated strategic plan should also increase municipal access to national and international capital and credits. Those capable of and interested in providing

funds and credits naturally feel more comfortable investing in projects that have been thoroughly analyzed.

Strategic planning is also good politics. Local business owners and the general population undoubtedly appreciate a concerted effort to forge community partnerships, in order to improve the business environment, spur economic activity and better ensure the retention of existing enterprises. Local governments can advertise their efforts to the community, which in turn should raise hopes and accountability for the project. ■

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Ukraine needs a new approach to SEZs

The new Government has announced that one of its economic priorities will be reviving the special conditions for business operations under Special Economic Zones (SEZs). ICPS economist Hanna Cherednychenko says that SEZs need to be changed from mere "tax resorts" where tax holidays are handed out, to "incubators" where the conditions for start-ups in priority sectors are generally favorable

Special economic programs are one way to resolve certain economic problems, but to be successfully applied, specific conditions must apply as well. For one thing, the purpose of setting up special programs has to be in step with the country's development goals over a particular period. For another, the features of any program have to be developed in such a way that they will actually facilitate reaching those goals.

The main goal of SEZs is to offer greater returns for using available resources

Given the situation in Ukraine today, the main purpose for SEZs to operate has to be to offer greater returns for utilizing available resources, not to encourage greater use of resources. Extensive growth resources, such as greater employment—unemployment has shrunk and is getting close to the "natural" level associated with sustainable growth—have effectively been exhausted in Ukraine at this point. This means that further growth will be sustained largely by increasing the competitiveness of the economy. Any new type of SEZ that is set up should be subordinated to this macroeconomic goal.

This means, in turn, that the features of a new SEZ program must increase the country's competitive advantages. One of the main barriers to improving Ukraine's

competitive edge has been the high cost of transactions, which is largely the result of a flawed institutional environment. Businesses are forced to spend an inordinate amount of money and time on non-productive processes: registering their businesses, getting the use of land, interacting with permit-granting bodies, and running a very complicated accounting system. What is more, they cannot develop any reliable long-term business plans because the way that the state regulates the economy is mutable and unpredictable, corporate legislation is poorly evolved and contradictory, and the legal system does not offer reliable protection for businesses.

SEZs must improve the business environment

This set of problems has led to very high risks for doing business, which, in turn, hampers investment, especially to projects with long-term ROI. According to foreign investors, it is these high risks associated with Ukraine's business environment that constitute the main barrier for both internal and foreign investment in Ukraine.

This is why any new SEZs will have to firstly be directed at radically improving the business environment on their own territories. Once these "pilot" reforms of business conditions prove themselves, the experience of the SEZs can then be extended to the entire country. Should they

fail, SEZs will have to continue being reformed until the best approach is found. In this way, the new SEZs will be testing grounds for reforms that can be applied nationwide.

Investors will believe in SEZs

This kind of SEZ has a slew of advantages over those programs that existed in Ukraine until 2005. The main one is that they will focus on the real problems faced by investors instead of compensating them for unresolved problems with tax and duty breaks. This kind of program will gain the confidence of investors, as it will be long-term when future Governments find little objective reason to change them significantly. Any direct and indirect costs to Ukrainian society for these programs will be lower than the overall gains, mainly because they will not be linked to the distorted economic incentives provided by tax breaks and the widespread abuse associated with previous SEZ programs.

According to the ICPS analyst, since this new program will directly increase the effectiveness, and therefore the competitiveness, of the country's economy, any gains will be felt across the economy, not only by individual businesses. The benefits will moreover be long-term, because they will not be based on the one-time gains in revenues associated with uncompetitive advantages but with the opportunity for any business whatsoever to operate at a lower level of transaction costs over the long run. ■

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